

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

|                                  |   |                 |
|----------------------------------|---|-----------------|
| THE APPLICATION OF FLEMING-MASON | ) |                 |
| RURAL ELECTRIC COOPERATIVE       | ) |                 |
| CORPORATION TO REFINANCE AND     | ) | CASE NO. 92-342 |
| CONVERT LOANS FROM FIXED TO      | ) |                 |
| VARIABLE RATE                    | ) |                 |

O R D E R

On August 17, 1992, Fleming-Mason Rural Electric Cooperative Corporation ("Fleming-Mason") filed a request that the Commission amend its prior Orders entered in Case No. 6229,<sup>1</sup> Case No. 7520,<sup>2</sup>

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<sup>1</sup> Case No. 6229, The Application of Fleming-Mason Rural Electric Cooperative Corporation for an Order Authorizing Said Corporation to Borrow Three Hundred Fifty Thousand (\$350,000) Dollars from the United States of America, and to Borrow from The National Rural Utilities Cooperative Finance Corporation, the Sum of One Hundred Fifty Thousand (\$150,000) Dollars, and to Execute a Note for Said Sum to the National Rural Utilities Cooperative Finance Corporation to Provide Funds for the Construction and Operation of Additional Electric Distribution and Service Lines, Order dated March 31, 1975.

<sup>2</sup> Case No. 7520, The Application of Fleming-Mason Rural Electric Cooperative Corporation for an Order Authorizing Said Corporation to Borrow One Million Seven Hundred and Ninety Seven Thousand (\$1,797,000) Dollars from the United States of America, and to Execute a Note for Said Sum to the United States of America, and to Borrow from the National Rural Utilities Cooperative Finance Corporation, the Sum of Eight Hundred and Eleven Thousand (\$811,000) Dollars, and to Execute a Note for Said Sum to the National Rural Utilities Cooperative Finance Corporation to Provide Funds for the Construction and Operation of Additional Electric Distribution and Service Line, Order dated September 27, 1979.

Case No. 8322,<sup>3</sup> and Case No. 10255<sup>4</sup> to authorize the conversion from a fixed to a variable interest rate for National Rural Utilities Cooperative Finance Corporation ("CFC") Loan Nos. 9005, 9013, 9016, and 9017. The terms of these 35-year loans originally provided for a fixed interest rate for the first 7 years, after which, the rate would be renegotiated. Since the execution of these loans, interest rates have been substantially reduced and CFC has allowed borrowers to convert to a reduced variable interest rate. The current fixed interest rate for these loans is 8.75 percent, 9.0 percent, 8.75 percent, and 9.5 percent, respectively. The variable rate applicable for these loans is 5.375 percent. On August 6, 1992, Fleming-Mason's Board of Directors voted to convert to the variable rate.

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<sup>3</sup> Case No. 8322, The Application of Fleming-Mason Rural Electric Cooperative Corporation for an Order Authorizing Said Corporation to Borrow One Million Six Hundred and Twenty-Five Thousand (\$1,625,000) Dollars from the United States of America, and to Execute a Note for Said Sum to the United States of America, and to Borrow from the National Rural Utilities Cooperative Finance Corporation, the Sum of Seven Hundred and Thirty-Three Thousand (\$733,000) Dollars, and to Execute a Note for Said Sum to the National Rural Utilities Cooperative Finance Corporation to Provide funds for the Construction and Operation of Additional Electric Distribution and Service Lines, Order dated October 27, 1981.

<sup>4</sup> Case No. 10255, The Application of Fleming-Mason Rural Electric Cooperative Corporation for an Order Authorizing Said Corporation to Borrow One Million Eight Hundred and Thirty (\$1,830,000) Thousand Dollars from the United States of America, and to Borrow from the National Rural Utilities Cooperative Finance Corporation, the Sum of Eight Hundred Thousand (\$800,000) Dollars, and to Execute a Note for Said Sum to the National Rural Utilities Cooperative Finance Corporation to Provide for the Construction and Distribution and Service Lines, Order dated December 13, 1988.

When converting from the fixed rate program to the variable rate program, CFC requires the payment of a conversion fee. The conversion fee for each loan is based on the difference in the interest rate on the note and CFC's long-term interest rate at the time the borrower elects to convert to the variable rate. The difference is applied to the outstanding loan balance at the start of the borrower's next first full quarterly billing cycle for the time remaining until a repricing option would have been allowed. A one-time, up-front fee of 25 basis points on the outstanding balance at the time of conversion is added to the conversion fee. The conversion fee could be paid either in quarterly payments or as a discounted up-front payment. The total conversion fee would be \$106,876.61 if paid quarterly and \$93,958.13 if paid up-front.

Fleming-Mason provided a series of Internal Rate of Return ("IRR") analyses for each loan it proposed to convert. Under the IRR approach, the goal of the borrower would be to utilize the interest rate program which produces the lowest IRR. For each loan, Fleming-Mason determined an IRR value for the following three different scenarios:

1. The current variable rate remained constant for the remainder of the pricing cycle ("Scenario I").

2. The current variable rate would begin increasing by .25 percent each quarter, beginning with the third quarter after conversion, for the remainder of the pricing cycle ("Scenario II").

3. The third scenario involved determining the variable interest rates which, when applied beginning with the third quarter

after conversion, would result in an IRR value approximately equal to the IRR value resulting from the current fixed interest rate. Fleming-Mason considered this the break-even scenario.

Each scenario was run twice showing the impact on the IRR value of each payment option chosen for the conversion fee.

The analyses indicated that, under either Scenario I or II, the resulting IRRs for the variable interest rate were lower than the IRR for the fixed interest rate. The scenario results also indicate it is beneficial to Fleming-Mason to pay the conversion fees up-front rather than quarterly. Scenario I resulted in a net cumulative savings of \$86,748.51 when the conversion fees were paid up-front and \$73,830.03 when the conversion fees were paid quarterly. Scenario II resulted in a net cumulative savings of \$3,536.38 when the conversion fees were paid up-front and a net increase in cost of \$9,239.92 when the conversion fees were paid quarterly. Under the assumptions incorporated in Scenario II, the increasing variable interest rate on individual loans resulted in significantly lower savings and in some instances a net increase in cost, when the conversion fee was paid quarterly. The net increase in cost occurred because one of the four loans had 18 quarters remaining in the current pricing cycle. However, savings were projected to occur through the first 13 quarters of the current pricing cycle.

In its request, Fleming-Mason indicated that it would pay the conversion fees over several periods due to its current cash position. Fleming-Mason stated that it viewed the assumptions in

Scenario II to be a "worst case" scenario. While stating that it did not see variable interest rates increasing or decreasing dramatically in the next few months, Fleming-Mason would continue to monitor interest rates and whenever indicators showed it to be advantageous, it would lock into a fixed rate. Based upon Fleming-Mason's analyses and the conditions presented in this case, the conversions of the four loans should result in interest savings on an IRR basis and the loans should be converted as requested.

IT IS THEREFORE ORDERED that:

1. The Commission's Orders entered in Case Nos. 6229, 7520, 8322, and 10255 be and they hereby are modified to authorize the conversion from a fixed to a variable rate program for CFC Loan Nos. 9005, 9013, 9016, and 9017.


2. Fleming-Mason shall notify the Commission of the closing date of the conversions and shall file, within 30 days of the conversions, all documents pertaining thereto.

3. Fleming-Mason shall file, along with its monthly financial report to the Commission, the current interest rate on its variable rate loans outstanding.


4. All other provisions of the Commission's Orders entered in Case Nos. 6229, 7520, 8322, and 10255 shall remain in full force and effect.

Done at Frankfort, Kentucky, this 21st day of September, 1992.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

  
Executive Director